No. 13006

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Estate of Ralph R. Huesman, Deceased, Nurma W. Huesman, Fred B. Huesman and The Farmers & Merchants National Bank of Los Angeles, Executors,

Appellants,

vs.

Commissioner of Internal Revenue,

Appellee.

APPELLANTS' REPLY BRIEF.

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APPELLANTS' REPLY BRIEF.

I.

The Deduction Taken by Appellants Pursuant to Section 162(a) Is Correct.

The first point of appellee's brief is devoted to an anticipated defense based on subsections (b) and (c) of Section 162, Internal Revenue Code. Although saving our rights under the entire section we have nevertheless based this appeal on subsection (a) of Section 162 and our point is that "gross income" as defined in Section 126 means the same thing as "gross income" under Section 162(a). Consequently, the first point of appellee's brief is entirely beside the point.

We are accused of overreaching—demanding more than that to which we are entitled (Appellees Brief, p. 13).

That assumes a large conclusion. Much depends upon the perspective and point of approach. If we start with the Statute (all that a taxpayer has to guide him) and logically construe it we conclude that within the code the term "gross income" has the same meaning in Section 162(a) as in Section 126. Such being the case there should be no deficiency assessment here. Approaching the problem from the other end, however, it does appear that the taxpayer has availed itself of quite a tax advantage. That may nevertheless be, and in this case is, quite justifiable. Although dissenting in a case cited by appellee (which incidentally is not in point), Mr. Justice Frankfurter had this to say which is most apropos (*United States v. Benedict*, 338 U. S. 692, 699):

> "The contrariety of views expressed by the Tax Court, the Court of Appeals for the Second Circuit, the Court of Claims and now by this Court in the task of harmonizing §§22(a), 117(b) and 162(a) of the Internal Revenue Code, 26 USCA, §§22(a), 117(b) and 162(a), FCA title 26, §§22(a), 117(b) and 162(a), conclusively proves the opaqueness, if not inherent incongruity, of those provisions. Courts must do the best they can with such materials since the power to write or rewrite legislation is not theirs. But the fact that a taxpayer may astutely apply his income so as to reduce the net base on which a tax is to be levied is not in itself ground for rejecting a construction of the Revenue Code which permits the reduced base, even though the particular mode of distributing his income may not have been contemplated in the enactment of the classes of exemptions and deductions within which the taxpayer brings himself. I, too, recoil from a bizarre result and if legislation is ambiguous its construction should avoid such a result. But the

rationale of construction ought not to be based on the impact of a single bizarre instance.

"A deduction for trust income applied to charitable purposes should not be disallowed merely because one taxpayer can effect the payment of a lower income tax than another through the mode by which the charitable contribution is made. Thus, where the trust instrument provides that all charitable donations shall be allocated from ordinary income and not from capital gains, the taxpayer may doubtless deduct such charitable contributions in full and may at the same time report any capital gains under the special capital gains provisions of the Code. This would secure the very benefits sought by the taxpayers here. The rule enunciated by the Court may therefore itself rest tax liability on the astuteness shown in drawing the trust instrument allocating income for charitable purposes.

"Since I am not alone in entertaining these doubts and they have not been dispelled, it seems appropriate to express them."

Two motions for additional time for filing appellee's brief have been filed with this court. Both assert by way of accompanying affidavits that the Justice Department and the Bureau of Internal Revenue are considering a revision of policy which may affect this case. Apparently policy was concluded in favor of appellee's present advantage. Nevertheless, may we inform the court that recently offering to compromise this case appellants offered to settle by yielding the deduction taken for estate taxes ($36,514.30), but that the offer was rejected unconditionally. Our position is, therefore, not the extreme one appellee would lead us to believe but rather one undertaking to find the right answer.

II.

The Legislative History Refutes Rather Than Supports the Commissioner's Position.

Appellants argued in our opening brief that the distribution in issue was made pursuant to a *residuary* legacy which authorized the distribution of income (Br. p. 17). Turning to the Senate Committee's report on Section 126 of the Code we find this statement (S. Rep. No. 1631, 77th Congress, Second Session, pp. 100-105; 1942 Cum. Bull. 504, 581):

> "Section 126(a)(2) of the Code, as added by subsection (e), provides that if the right to receive an amount described in section 126(a)(1) is transferred by a person described in such subsection, the fair market value of such right at the date of the transfer shall be included in the income of such person, plus the amount by which any consideration received on such transfer exceeds the fair market value of such right. Thus, if the right to receive the income is disposed of, as by gift, the donor must include the fair market value of such right in his gross income, in view of his benefit from such right. However, if the person to whom such right is transferred is a person described in section 126(a)(1) as being entitled to such right by reason of the death of the decedent (for example, the beneficiary of the trust of such right), or by bequest, inheritance or devise from the decedent (for example, a specific legatee of such right *or the residuary legatee of the estate*), the fair market value of the right is not included in the income of the transferor, but the transferee must include the amount received in his income under the provisions of section 126(a)(1), or if he transfers such right to a person not described in section 126 (a)(1), then he must include the fair market value of this right in his income." (Emphasis supplied.)

Thus the Committee Report recognized that a distribution of income could, as it was in this case, be properly made to a residuary legatee. At no place in any of the Committee Reports, however, was the question of the transfer of income to an exempt institution considered. Although the Commissioner states that he relies on the legislative history to support his position yet he nowhere quotes or specifies precisely what there is in the Committee Reports that supports him.

Addressing ourselves generally to the Commissioner's brief he states at the outset with apparent lack of conviction that there is "serious doubt" as to whether the bonus item was actually distributed. That is a matter of fact concerning which there can be no question in view of the stipulation [R. 35].

He then states that residuary legatees of given percentages of a residuum take proportionately of both corpus and income. He cites *Grey v. Commissioner,* 118 F. 2d 153, and says to "compare" *United States v. Benedict,* 338 U. S. 692; *Warburton v. Commissioner,* 1951 P-H. T. C., paragraph 51,036, and *Clarke v. United States,* 189 F. 2d 101. *Grey v. Commissioner,* the case cited primarily in support of the asserted proposition involved not a question of distributable income but of the allocation of a depreciation deduction. None of the other cases support the statement asserted. But in any event it is in this case a stipulated fact that the bonus or income item was pursuant to court order actually paid to Loyola [R. 36] all of which makes the Commissioner's argument on this

point irrelevant and also distinguishes *Wellman v. Welch,* 99 F. 2d 75 (C. C. A. 1), which did not involve a *residuary* legatee and where the parties stipulated that funds were indiscriminately applied to the payment of pecuniary legacies.

Finally, we wish to call the court's attention to the fact that the Commissioner's abstract of *Old Colony Co. v. Commissioner,* 301 U. S. 379, is not only erroneous but misleading on a very crucial point (Appellee's Brief, p. 16). The abstract states that "The trust authorizes the trustees to pay trust *income* to charities." The fact is that the trust there, as did the residuary clause in the case herein at issue, authorized the payment of *principal* or *income* to the designated purposes. Hence, it is apparent that *Old Colony Co. v. Commissioner* is directly in point on the issue for which it is cited.

Respectfully submitted,

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